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IN THE

Supreme Court of the United States

October Term, 1946.

No. 268

O. WILLIAM LOWRY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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SUBJECT INDEX.

	PAGE
Petition for Writ of Certiorari	1-5
Statement of Matter Involved	1
Basis Upon Which This Court Has Jurisdiction	3
Reasons for Allowance of Writ	4
Prayer of the Petition	5
Brief in Support of Petition for Writ of Certiorari	7-16
(a) Index	7
(b) Opinions below	7
(c) Jurisdiction	7
(d) Statement of the case	8
(e) Errors assigned	10
(f) Argument	11

Cases Cited.

Commissioner of Internal Revenue v. Tower, (October Term, 1945, decided February 25, 1946)	1
Edson v. Lucas, 40 Fed. (2d) 398	15
Molenda v. Simonson, 307 Mich. 139	13

Statutes Cited.

28 U. S. Code 347, para. (a)	3

Textbooks Cited.

1 Fletcher Cyc. of Corp. (Per. Ed.), p. 2	14

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PETITION FOR WRIT OF CERTIORARI.

To the Honorable, The Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of O. William Lowry, a citizen of the State of Michigan, respectfully shows:

Statement of Matter Involved.

The matter involved in the case of this petitioner (which case was consolidated for hearing in the court below with that of Charles R. Sligh, Jr., who is not petitioning) is the taxability of the petitioner on income of petitioner's wife which she received under a limited partnership agreement.

The Circuit Court of Appeals for the 6th Circuit held (Rec. 222; *Lowry* v. *Commissioner of Internal Revenue*, 154 F. 2d 448) that the present petitioner's case was controlled by the decision of this Court in *Commissioner of Internal Revenue* v. *Tower* (October Term, 1945, decided February 25, 1946).

There is no dispute anywhere in the record of the fact that the petitioner's wife, Sara H. Lowry, made a capital contribution to the partnership consisting of 450 shares of stock in a corporation which shares she had received as an outright gift from her husband more than eighteen months prior to the making of such contribution to the partnership assets (Rec. 43).

Furthermore, there is not a scintilla of evidence sustaining any conclusion that the antecedent gift of the corporate shares which Sara H. Lowry contributed to the capital of the partnership was merely a step in the proceeding by which the partnership was formed, more than a year later (Rec. 47). There is no finding of fact anywhere by the Tax Court that such transfer of corporate shares from husband to wife was intended to be or was a step in the plan for the formation of the partnership (Rec. 182-183).

It is true that in the opinion filed by a majority of the Tax Court it is said (Rec. 192):

> "It is clear that the petitioners made the alleged gifts of stock in the corporation to their wives pursuant to a plan involving the dissolution of the corporation and the transfer of assets to a partnership."

Six judges (Black, Arundell, Leech, Mellott, Disney and Van Fossan) dissented from this opinion (Rec. 196-201) and in the absence of either evidence or of a finding of fact by the Tax Court that the gift of corporate stock to Mrs. Lowry was made with a view to her using it as a

contribution to a partnership thereafter to be formed, it is submitted that the reasons given by the majority of the Tax Court for their opinion do not rise to the dignity of findings of fact to which this Court has given conclusive effect.

Basis Upon Which This Court Has Jurisdiction.

The jurisdiction of this Court is given by Section 240 of the Judicial Code as amended by the act of February 3, 1925, 28 U. S. Code 347, para. (a), which provides in part:

> "(a) In any case * * * in a circuit court of appeals * * * it shall be competent for the Supreme Court of the United States * * * to require by certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by it, and with like effect, as if the cause had been brought there by unrestricted appeal."

The provision of Rule 38 of this Court which is deemed pertinent to the allowance of this petition for certiorari is that the Circuit Court of Appeals has decided an important question of Federal law which has not been but should be settled by this Court and has decided a Federal question in a way probably in conflict with applicable decisions of this Court.

The question presented is whether a wife who makes a contribution to a partnership in which her husband and two other persons are to become engaged is a bona fide owner of a partnership interest where the contribution made by her was under State law her own property, even though it originated more than a year and a half earlier from a gift made to her by her husband—there being no evidence or finding of fact that the gift was made to her as part of a plan of forming such partnership.

Reasons For Allowance of Writ.

The writ should be allowed because the court below has given the same effect to mere discussions contained in the opinion of the Tax Court as the Supreme Court allows to findings of fact of the Tax Court. Although there is no finding of fact that the gift of corporate stock from the petitioner to his wife, Sara H. Lowry, in May, 1937, was any part of the plan by which a limited partnership was formed more than eighteen months thereafter, the language of the Tax Court in giving the reasons for its decision has been accepted by the Circuit Court of Appeals as though that language constituted findings of fact.

Furthermore, the Circuit Court of Appeals has failed to recognize that under the decisions of this Court, income taxes cannot be levied against the husband if, in fact, his wife is a partner—and that in determining the fact of a partnership the question of the wife's contribution to the capital of the partnership must be considered.

The Circuit Court of Appeals did not recognize the absence of evidence that the gift to Mrs. Lowry was any part of the plan for formation of a partnership and was misled by the reasons (as distinguished from findings of fact) of the Tax Court.

Another reason for the allowance of a writ is that this Court—should it adhere to the fullest implication of its family partnership decisions—will create a distressing condition. The property rights of husbands and wives as between themselves are governed by State law and if this Court has meant to take the position that the actualities of the State law may be entirely disregarded in determining Federal income tax questions, the result will be that in numerous instances husbands will be obligated to pay over to their wives without deduction for Federal taxes amounts

which such taxes have completely wiped out. Unless this Court is prepared to obliterate substantive rules of State law by imposing income tax rules which make it impossible to recognize the actualities of the property rules of the States, it should reconsider some of the language of its decisions on family partnerships.

Prayer of the Petition.

Wherefore, your petitioner, O. William Lowry, respectfully prays that a writ of certiorari be granted in this case to review the judgment and decision of the United States Circuit Court of Appeals for the 6th Circuit entered April 3, 1946, in the cause there entitled "General Number 9920, O. William Lowry, Petitioner, *vs.* Commissioner of Internal Revenue, Respondent", which in the United States Tax Court bore Docket No. 112691.

O. William Lowry,
Petitioner,
By Owen Rall,
Tim G. Lowry,
His Attorneys.

IN THE

Supreme Court of the United States

October Term, 1946.

No. ....

O. WILLIAM LOWRY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

(a) Index.

The index to this brief will be found ahead of the petition for certiorari to which this brief is bound.

(b) Opinions below.

The opinion of the Tax Court is reported, 3 T. C. 730, and of the Circuit Court of Appeals, 6th Circuit, 154 F. 2d 448.

(c) Jurisdiction.

In the petition for certiorari, under the jurisdictional point, will be found the statutory and rule 38 provisions which authorize a writ of certiorari.

(d) Statement of the case.

Effective January, 1937, the Charles R. Sligh Company, furniture manufacturers of Holland, Michigan, with 1800 shares of corporate stock outstanding, was owned 900 shares by petitioner, O. William Lowry, and 900 shares by Charles R. Sligh (Rec. 37, 39). Sara Lowry, petitioner's wife, and Charlotte K. Sligh, Charles R. Sligh's wife, were elected directors at that time and together with their husbands served as directors as long as the corporation continued in existence (Rec. 37). A portion of petitioner's then stock holdings was purchased in January, 1937, from Mr. Matheson with money, $15,000.00, borrowed from a bank on the joint note of petitioner and his wife (Rec. 83, 109).

Petitioner desired to make a gift of a portion of his stock to his wife so that she might have independence of petitioner's creditors (Rec. 41). On May 24, 1937, petitioner gave his wife 450 shares of the 900 shares of stock owned by him, accompanying it with a letter which is not and cannot be challenged, stating in part (Rec. 43):

> "This is a gift from me to you, and is now your property to do as you choose. There are no restrictions upon your rights as a stockholder and you are entitled to receive any dividends which may be paid on the stock from this day forth."

In order to make this unconditional gift, petitioner obtained the release of the shares from the bank where they were pledged as collateral to the joint note of petitioner and his wife (Rec. 85, 110).

At the time in January, 1937, of acquiring control in equal shares (through purchase of Matheson's interest which had been one-third), Mr. Sligh and the petitioner discussed a change in the business structure from that of

a corporation because it was unwieldy, reports to be made out, etc., and because of tax savings (Rec. 44). No partnership was formed because that would have involved liabilities that they were not sure they wished to assume (Rec. 45).

A year after Mrs. Lowry received her stock, that is, in the spring of 1938, there were discussions about the formation of a limited partnership, and eighteen months after Mrs. Lowry received her stock a limited partnership was formed the validity of which is not challenged under the laws of the state of Michigan. Mrs. Lowry surrendered her stock interest in the corporation for a corresponding interest, as a limited partner, in the partnership (Rec. 47). In the meantime, Mrs. Lowry received a dividend of $7,500.00 paid in corporate notes in May 1937 (Rec. 54-55, 124) and of $1,800.00 paid in cash on May 25, 1938 (Rec. 55, 124).

There was no finding of fact by the Tax Court that the petitioner's gift of stock was not actual, unconditional and complete. It found as a fact (Rec. 190):

> "Petitioners did not relinquish dominion and control over any part *of the assets of the corporation* by reason of the gift of stock in the corporation to their wives, and, *consequently,* the wives did not contribute any property to the capital of the partnership."

The shares of stock involved in petitioner's gift never were "assets of the corporation." No one ever pretended that they were. There is no finding of fact anywhere in the record that the gift of shares was not unconditional, actual and complete. As an officer of the corporation, of course petitioner's control over its assets was the same after as before his gift of corporate stock to his wife. But that is wholly beside the point. The question here was not whether the assets of the corporation were under

the control of petitioner and Charles R. Sligh, but whether the shares of corporate stock given by petitioner to his wife continued to be under petitioner's control. There is no evidence and there is no finding that they were.

The entire basis of the Tax Court's decision was that the petitioner's wife made no contribution to the capital of the partnership. In turn, this is based solely on the untenable theory that the lack of a change in control of the assets *of the corporation*—not of its corporate stock—proves that the gift of corporate stock is invalid, so that its use more than eighteen months later cannot constitute a contribution to the capital of the partnership.

(e) Errors assigned.

The Tax Court and the Court below erred:

1. By assuming that a gift of corporate stock was legally the same as a gift of an equivalent portion of corporate assets and by attempting to test the validity of the gift of corporate stock by looking at the control over corporate assets instead of the control over the corporate stock which was the subject of the gift. A person owning shares in American Telephone and Telegraph Company, as an example, has no control whatever over the assets of the company, but he is no less the owner of valuable shares.

2. In testing the validity of the gift of corporate stock made eighteen months before by referring to the provisions of the partnership agreement made in December, 1938.

3. In deciding that the petitioner was not carrying on business in a partnership form under section 181 of the Internal Revenue Code.

4. In sustaining the deficiency against petitioner for the years 1939 and 1940.

(f) Argument.

The two concluding paragraphs of the Tax Court's findings of fact are as follows (Rec. 190):

> "Respondent has included in the income of each petitioner for each year, 1939 and 1940, the amounts reported by the wife in her separate return as her share of partnership income. The reason given for such determination, as stated in the deficiency notice, is that the wife's share of partnership income is held taxable to the husband because the wife rendered no services and contributed no capital, as such, to the business, and because the husband in the close family group retained 'dominion, control, and administration' of the business.
>
> "Petitioners did not relinquish dominion and control over any part of the assets of the corporation by reason of the gifts of stock in the corporation to their wives, and, consequently, the wives did not contribute any property to the capital of the partnership."

This is an evasive and immaterial finding. The conclusion that "the wives did not contribute any property to the capital of the partnership" is a perfect *non sequitur*, based upon an immaterial finding of fact and therefore the conclusion falls of its own weight. The decision based upon it also must fall.

The dissenting opinion of Judge Black (Rec. 196) called attention to the error in the finding of fact, but not to its immateriality.

Judge Black, with whom Judges Arundell, Leech, Mellott and Disney concurred, expressed the dissent from these conclusions (Rec. 196-197):

> "I do not agree to the correctness of the above ultimate findings of fact. I think it is contrary to the findings of fact which have preceded it. Based on the

general findings of fact which the majority has made, I would find ultimate facts as follows:

> "Petitioners Lowry and Sligh made irrevocable gifts to their wives of 450 shares each of Charles R. Sligh corporation stock. When this corporation was liquidated and dissolved in December, 1938, the wives became the owners of their proportional part of the assets of the corporation. The partnership agreement entered into December 16, 1938, between petitioners and their wives created a legal, valid partnership between them with ownership of partnership profits as fixed in the partnership agreement. The earnings of the partnership thereafter allocable to the respective partners under the terms of the partnership agreements were the income of the respective partners to whom allocable."

Judge Disney wrote a separate dissenting opinion to express his view that the conclusion of the majority was an erroneous conclusion of law since "the majority view fails to give weight to certain basic law on the subject of gifts" (Rec. 198). In this opinion Judges Arundell, VanFossan, Black and Leech concurred.

Thus six of the sixteen judges of the Tax Court held that there was no sufficient legal basis in the facts as found for the conclusion of the majority.

Two propositions were clearly held by the Tax Court (Rec. 192):

> "We have said that it is essential that a contribution be made by each member of a partnership of either property or services in order that a partnership may be found to exist. *Thomas M. McIntyre*, 37 B. T. A. 812. See also, *Meehan* v. *Valentine*, 145 U. S. 611. In this case the wives of petitioners did not contribute any services to the business. The question to be considered is whether they contributed any capital or property to the business.
>
> * * * * *

"If the wives received such dominion over property, it will follow that they, individually, made real contributions to the capital of the partnership."

This statement recognizes:

(1) That if a wife contributed capital the partnership existed; and

(2) That if the gifts of corporate stock were valid Mrs. Lowry contributed capital to the partnership.

There was an ~~no~~ error of law in holding that the gifts of stock were ineffective. Were it not for the result reached in the court below, it could not seriously be argued that the gift to Mrs. Lowry was not to be recognized. The subject matter of the gift was shares of corporate stock. There was ~~no~~ positive proof of delivery, of donative intent, and of acceptance. The shares were transferred on the stock book of the corporation and a certificate was issued in the name of the donee. She did not endorse her certificate for transfer. She did not give her husband a power of attorney to transfer her shares.

All elements of a valid and effective gift were present. In *Molenda* v. *Simonson*, 307 Mich. 139, pp. 141-142, it was said:

> "Three elements are necessary to constitute a valid gift. The donor must possess the intent to gratuitously pass title to the donee. *Chamberlain* v. *Eddy*, 154 Mich. 593, 603, and *Geisel* v. *Burg*, 283 Mich. 73, 80. An actual or constructive delivery is essential to effectuate a gift either *inter vivos* or *causa mortis*. *In re Van Wormer's Estate*, 255 Mich. 399. In order for the gift to be consummated, the donee must accept it, although a gift beneficial to the donee will be presumed to have been accepted. *Holmes* v. *McDonald*, 119 Mich. 563 (75 Am. St. Rep. 430)."

There is no evidence and no finding of fact anywhere in the record that the undisputed, unconditional and outright

gift of stock from petitioner to his wife in May, 1937, had anything to do with the later formation of the partnership. We challenge the respondent to point out any substantial evidence that the two things were related in any way except by the intervention of eighteen months.

The majority of the Tax Court said (Rec. 192):

> "Petitioners were the owners of all of the stock and, therefore, of all of the assets of the corporation in the beginning. If they made bona fide gifts of interests in part of the assets to their wives, through the medium of transfers of stock, their wives must have received complete dominion and control over property, and petitioners must have divested themselves of such control. Such rule is well established. See *Edson* v. *Lucas,* 40 Fed. (2d) 398, and authorities cited therein on the essential elements of a bona fide gift. If the wives received such dominion over property, it will follow that they, individually, made real contributions to the capital of the partnership."

The fallacy in this is obvious. The petitioner as owner of corporate stock was not the owner "of all of the assets of the corporation in the beginning".

1 Fletcher Cyc. of Corp. (Per. Ed.) p. 2, states:

> "Introductively it may be assumed that now a corporation is one of the forms of association, having rights and relations, and the characteristic attribute of a legal entity distinct from that of the persons who compose it or act for it in exercising its functions."

No right to deal directly with the corporate assets was an incident of ownership of the stock. The petitioner had no such power before the transfer and could confer no such power on his wife. The degree of control over the affairs of the corporation which Mrs. Lowry acquired or possessed as owner of a minority interest in its stock is a question to be answered by the law of corporations, not by the law of gifts.

In *Edson* v. *Lucas*, 40 Fed. (2d) 398, it is pointed out that the delivery necessary to effect a valid gift must be such that the donor parts with dominion and control, as well as possession, *over the subject-matter of the gift.* We quote from p. 405:

> "It is safe to say that, where there is a complete transfer of the legal title to the subject-matter of the gift, together with some equitable or beneficial present interest, to the donee, without power of revocation in the donor, coupled with the intentional delivery of complete possession, dominion and control over the gift, the gift is not invalid because of conditions imposed by the donor which are not inconsistent with the immediate vesting of such legal title in the donee."

When attention is directed to the matter, it is rather obvious that, in the statement last quoted from the opinion, the majority of the Tax Court were confusing the wives' degree of control over corporate assets with their degree of control over shares of stock. Having made this fundamental error it was much easier to make the next error, which consisted of using the partnership agreement to test the character and extent of the ownership conferred by the transfer of the stock. Since the property which was the subject matter of each gift was stock, not an undivided interest in corporate assets or even a share in the partnership, the reasoning was plainly wrong. There is no proof whatsoever, and no finding by the Tax Court, that there was any restriction or limitation upon ownership *of the stock as property* by the wives. There is no finding that there was any restriction upon exercise by each wife of every right usually exercisable by a stockholder, unless the finding that the stock had to be first offered to the remaining stockholders before it could be sold to an outsider, (Rec. 183), is such a restriction. There is not even a suggestion that either Lowry or Sligh could, in any contingency, get back his stock from his wife.

It is, therefore, abundantly clear that, once this error in the reasoning of the Tax Court is corrected, settled principles of law demand that the gifts of stock be held valid. Such holding is decisive of the case and requires reversal.

There is not even reasonably close relationship in point of time to justify the conclusion that the gift made by Petitioner Lowry was conditional. The holding that that gift was not *bona fide* is the *reductio ad absurdum* of the failure of the majority of the Tax Court to apply settled legal principles to determine whether the gift was valid, and of the confusion of control over stock with control over assets of the corporation whose stock was involved.

The transfer to Mrs. Lowry was made on May 25, 1937, (Rec. 43). Lowry wanted his wife to have some property of her own, (Rec. 84, 111). Before he made the gift the formation of a partnership had been discussed and *Sligh and Lowry had decided against doing so* because they were not ready to assume the personal liability which a partnership would involve, (Rec. 45). The proofs affirmatively show that Lowry could not have had in mind the formation of a partnership when he gave half his stock to his wife. Mrs. Lowry received two dividends upon the stock amounting to $9,300, (Rec. 54-55, 86-87, Exhs. 12 and 13). It is not suggested that her husband had any claim to this money.

Since there is no rational basis in the undisputed facts for even an inference that the gift of stock was made upon condition that a partnership be formed, the petitioner's wife contributed capital to the partnership and the partnership should be recognized.

The dissenting opinions in the Tax Court were plainly correct and the decision of the Circuit Court of Appeals in affirming the majority decision should, we submit, be

reversed. The petitioner will perhaps ask leave later to submit a supplemental brief on the law as disclosed by recent so-called family partnership cases, but it is apparent that the basis of the Tax Court's decision was wrong and that the decision should fall with the disclosure of that error.

Respectfully submitted,

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July 1, 1946.

INDEX

PAGE

I. The Tax Court's findings of fact relied on by the respondent are immaterial or are not supported by any evidence.......................... 1-5

II. If the *Tower* case is authority for the decision of the Court below, that case should be re-examined and modified................................ 6-13

Cases Cited

S. Kenneth Alexander, 6 T.C. 804, April 26, 1946, CCH Decision 15,102....................... 11

Willis B. Anderson, 6 T.C. ......, No. 133, May 6, 1946, CCH Decision 15,133.............. 8

Claire L. Canfield, 7 T.C. No. 18, CCH Decision 15,225, decided June 13, 1946..... 12

Commissioner of Internal Revenue v. Tower, 328 U.S. ...., No. 317, decided Feb. 25, 1946..6, 7, 8, 9, 10, 11, 12

Dobson v. Commissioner of Internal Revenue, 320, U.S. 489....................................1, 2, 4, 5

Harrison v. Schaffner, 312 U. S. 579................. 7

Mauldin v. Commissioner of Internal Revenue, 155 F. 2d 666 (4th Cir., May 16, 1946)................. 10

Francis A. Parker, 6 T.C. ...., No. 125 May 7, 1946, CCH Decision 15,135.............. 9

Harry Shulak, April 30 1946, Docket 6654, CCH Decision 15,151 (M).....................9, 11

Statutes Cited

Section 1117, Internal Revenue Code................ 2

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

REPLY BRIEF

May it Please the Court:

I.

The Tax Court's findings of fact relied on by the respondent are immaterial or are not supported by any evidence.

In answer to our argument that the findings of fact by the Tax Court were not sufficient to support its judgment, Respondent contends, citing (p. 7) cases ante-dating *Dobson* v. *Commissioner of Internal Revenue,* 320 U.S. 489, that any statement of fact which can be spelled out of

the Tax Court's opinion may be used to support its decision, notwithstanding the Tax Court's failure to make a specific finding of fact on the question in issue.

In the *Dobson* case, this Court said (p. 502):

> "In view of the division of functions between the Tax Court and reviewing courts it is of course the duty of the Tax Court to distinguish with clarity between what it finds as fact and what conclusion it reaches on the law."

This "distinction" certainly cannot be made by the Tax Court "with clarity" if when professing to make findings of fact, labelled as such, that court omits a finding of fact on the most important factual question before it—as it did here.

It is true that under Section 1117 of the Internal Revenue Code the Tax Court may "include in its report upon any proceedings its findings of fact *or* opinion *or* memorandum opinion" and that these alternatives permit the Tax Court to dispense with formal findings of fact if it wishes. But in the present case the Tax Court did not dispense with findings of fact; it undertook to make specific findings. If such findings may not be looked to by a litigant to determine the facts by which the taxpayer is bound under the *Dobson* case, where must the taxpayer look? How, in the language of the *Dobson* case, may the Tax Court "distinguish with clarity between what it finds as fact and what conclusion it reaches on the law" unless the Tax Court puts its factual findings where they belong, namely, in the findings of fact?

We submit that under the *Dobson* case, the Tax Court must when it professes to make findings of fact, make them complete enough to sustain its judgment. In no other way can the requirement of this Court laid down in the *Dobson* case be enforced.

We pointed out in our petition (p. 11) that the "findings of fact" of the Tax Court (R. 190) found that the petitioner's gift of stock to his wife, which stock she contributed to the capital of the partnership, was an ineffective transfer because the petitioner "did not relinquish dominion and control over any part *of the assets of the corporation* by reason of the gifts of stock in the corporation." We further pointed out that this finding of the Tax Court was immaterial because the question in the case was not whether the petitioner's wife acquired dominion over the assets of the corporation, but whether she acquired dominion *over the corporate stock* which was the subject of the gift.

The only comment of the Respondent on this argument is (p. 7):

"This finding was of itself sufficient to support the conclusion of the Tax Court that the wives were not conducting a business with their husbands as a partnership within the meaning of the Federal income tax statutes."

This bland statement is no answer to our argument. This sentence does not even refer to the status of the Petitioner's wife as a stockholder in the corporation, a status which she occupied for eighteen months before the partnership was formed, but ignores our arguments concerning *corporate* status and passes at once to the question of *partnership* status.

Hence, the Respondent has not answered our contention (Petition, p. 15) that the Tax Court confused the degree of control over corporate *assets* with the degree of control over shares of corporate *stock*.

Regardless of the inadequacy of the *findings of fact*, the Tax Court's judgment is unsound because the so-called finding of fact in the Tax Court's *opinion* (that the trans-

fer of stock in the corporation by petitioner to his wife was a step in the formation of the partnership) is not sustained by any evidence whatever. As already stated, the crux of this case was whether the Petitioner's wife had control of the *corporate shares* which were an outright gift to her eighteen months before the partnership was formed, and not whether she had control over the *corporate assets* during that period.

But the Respondent says (p. 7):

"The court below properly accepted as a finding of fact the statement in the Tax Court's opinion (R. 192, 195) to the effect that the gifts were made pursuant to a plan to dissolve the corporation and create a partnership with the wives as partners."

Assuming for the sake of argument that notwithstanding the instruction of this Court in the *Dobson* case it is permissible to require the taxpayer to search the opinion of the Tax Court for findings of fact, still the Respondent has not met the challenge on page 14 of our petition to point out any substantial evidence that the gift of stock from the Petitioner to his wife in May, 1937, had anything to do with the formation of the partnership eighteen months later.

In the *Dobson* case this Court said (p. 501):

> "Its [the Tax Court's] decision, of course, must have 'warrant in the record' and a reasonable basis in the law. But 'the judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body.'"

There is not one iota of evidence in the record to support the so-called finding of fact in the Tax Court's opinion to the effect that the gift of corporate stock in May, 1937, had any relationship whatever to the partnership formed eighteen months after the gift. The failure

of the Respondent to point to such evidence in the face of the challenge made in our petition for certiorari (p. 14) is a confession that with respect to the present Petitioner there is no evidence that the gift of the corporate stock and the formation of the partnership were steps in a single plan. The Petitioner's situation has been confused with that of his fellow shareholder, Charles R. Sligh, whose gift of corporate stock to his wife was almost contemporaneous with the formation of the partnership.

We have shown that so far as the Petitioner Lowry is concerned the Tax Court erred first in holding that the gift of corporate stock by Petitioner to his wife failed because it did not carry with it control over the assets of the corporation, and second, in holding without evidence that the transfer of corporate stock by petitioner to his wife was made pursuant to a plan to dissolve the corporation and form a partnership.

We have fulfilled the burden imposed by the *Dobson* case which held (p. 502) that "when the court cannot separate the elements of a decision so as to identify the clear-cut mistake of law, the decision of the Tax Court must stand."

We repeat what we said in our concluding sentence of the petition (p. 17): "It is apparent that the basis of the Tax Court's decision was wrong and that the decision should fall with the disclosure of that error."

The error we rely on is a clear-cut error of law.

II.

If the *Tower* Case is authority for the decision of the Court below, that case should be re-examined and modified.

The Court below relied upon *Commissioner of Internal Revenue* v. *Tower*, 328 U.S. .., No. 317, decided by this Court February 25, 1946, as authority for its decision, although it recognized that there were differences between the factual situation in the *Tower* case and in this one with respect to the Petitioner Lowry. Notwithstanding these differences, it affirmed the Tax Court in the case of Lowry as well as in the case of Sligh.

Not only are there difference of fact between the *Tower* case and this case, but a proper application of the language of the *Tower* case would indicate that the Petitioner Lowry's situation is not one which is governed by the *Tower* case.

In that case, Tower gave his wife shares of stock in a corporation on condition that they be contributed to the partnership thereafter formed. Three days later, the wife in the meantime having received no dividends, the corporation was liquidated and the assets were turned over to the partnership. The Tax Court held that the parties did not intend to carry on business as a partnership. This Court said:

"This finding, *since supported by evidence,* is final."

In the present case, the gift of corporate stock was outright. The transfer was not conditional upon the petitioner's wife contributing her share in the corporation to a partnership. Furthermore, no partnership was formed until eighteen months after the gift had become final and during which time dividends upon the wife's shares of corporate stock had been paid to her. When

the partnership was formed there is no suggestion that anyone but petitioner's wife was entitled, as of right, to the corporate assets which her corporate stock entitled her to receive on liquidation and which she contributed to the partnership.

For eighteen months, Petitioner's wife had had control and possession of her shares of corporate stock. It was hers, without earmarks. It was her property under the laws of the state of Michigan. Her husband could no more take it away from her than he could deprive her of property purchased by her or property earned by her or property inherited by her. It was hers. Being hers, when she contributed it to the partnership, she was entitled to such share in the partnership income as the contribution brought her under the terms of the partnership agreement. To hold otherwise in the case of a business where, as here, capital is just as important a factor as services in the production of income, is to say that income taxes in one year are to be based on the history of the property out of which such income arises.

In the *Tower* case this Court held that the findings by the Tax Court led to the inference that the husband still "controls" the income from the partnership, and stated definitely:

> "It is the command of the taxpayer over the income which is the concern of the tax laws—*Harrison* v. *Schaffner,* 312 U.S. 579."

There is no finding in the present case that Petitioner's wife lacked control over the income from the corporate stock, but, instead, the Tax Court went off on a tangent in asking and answering this question (Rec. 195):

> "Did petitioners divest themselves of ownership in one-quarter, each, *of the assets of the corporate business,* putting complete ownership of *property,* or

> of undivided interests in *property,* in their respective wives, so that they, in turn, were in a position to contribute capital to the partnership?" (Italics ours).

The Tax Court's negative answer to this question is based upon its refusal to recognize the existence of the corporation as insulating its shareholders from personal ownership of corporate assets. Under the *Tower* case, the question of "control" does not refer to control of corporate assets, but refers to "command over income."

In determining whether Petitioner's wife made a contribution of capital, the Tax Court omitted to find whether the Petitioner made a *bona fide* gift of corporate stock to his wife, but relied upon the immaterial finding (Rec. 196) that Petitioner did not relinquish dominion and control over *the interests in property* which he purported to give his wife *by way of transfers of stock in the corporation.* Petitioner did not purport to give his wife dominion over corporate assets; he did actually give his wife dominion over shares of corporate stock. There is no evidence or finding to the contrary.

Nor does the Tax Court make any finding supported by evidence that Petitioner had "control" of his wife's share of the partnership profits, except (Rec. 195) that the general partners (Sligh and Lowry) could decide when the partnership profits should be distributed, and that the limited partners had no such right. This is not a finding that the Petitioner had "command" of the income in the sense in which the word is used in the *Tower* case. An owner of A. T. & T. stock is taxable on income received on his stock even though the Board of Directors, and not he, has the sole power to determine when dividends shall be declared and paid. On the all-important question of "control" of the Petitioner over income from the partnership, the Tax Court's opinion

and findings are not definite or specific and to the extent that by a narrow inference they do support the Tax Court's decision, they are based on a clear-cut error of law—a confusion between control of corporate property, as such, and ownership of corporate stock which has a well-defined dissimilarity in law from ownership of the corporate assets.

If the test of "control" or "command" of income to which the *Tower* opinion gives at least verbal approval be applied, no great injustice is done. If the present case had been decided by a determination of the question whether in fact the Petitioner had control under Michigan law over the partnership income allocated to his wife and then taxed by the Respondent to the Petitioner, no complaint could be made. But this all-important question was not determined except in the immaterial holding mentioned above that the *time* of distributing partnership profits was a determination lodged with the general partners and not in the limited partners.

The decision in the *Tower* case that the income tax collector need not recognize as valid a partnership recognized as valid by state law has now given rise to cases holding that partnerships not recognized by state law may be recognized for Federal tax purposes—*Willis B. Anderson,* 6 T.C. ..., No. 133, May 6, 1946, CCH Decision 15,133; *Francis A. Parker,* 6 T.C. ..., No. 125, May 7, 1946, CCH Decision 15,135.

The decision in the *Tower* case has also led to dispute as to what a capital contribution "originating" with the wife is. Are prior *bona fide* gifts to her from her husband not to be recognized as her property, although (as here) she has paid tax previously on income from such property? Is a gift to be forever earmarked?

In *Harry Shulak,* CCH Decision 15,151 (M), April 30,

1946, Docket 6654, the Tax Court held that money given to a wife three years before constituted a capital contribution originating with the wife.

In *Mauldin* v. *Commissioner of Internal Revenue*, 155 F. 2d 666 (4th Cir., May 16, 1946) a wife's partnership interest acquired by gift in 1936 and taxed to her in 1937, 1938 and 1939, was held insufficient as a contribution to partnership capital of a new partnership in 1940. One of the three judges, (Timmerman, D. J.) dissented sharply, stating in part (p. 672):

> "By the phrase 'capital originating with her', the Court undoubtedly meant money or other asset which the wife owned in her own right, regardless of how she may have acquired it. It would be unreasonable to interpret the quoted words as meaning that a wife could not invest money or property which she lawfully acquired by way of gift, inheritance or otherwise in a partnership with her husband or with her husband and another. Simply because a woman is married is no reason for limiting the uses to which she may put her property. In common with all others, she is entitled to the equal protection of the law. We cannot read into the Supreme Court opinion a meaning of antagonism to married women."

It is true that in the instant case the Tax Court did not place its decision on the claim that capital contributed by the Petitioner's wife did not "originate" with her; it held that she had had nothing to contribute because the prior transfer of corporate stock was ineffective. Nevertheless, the *Tower* case is an effective bar here unless the term "originate" is construed, as it should be, to include property actually belonging to the wife regardless of its previous history.

In the instant case, the Tax Court recognized that a capital contribution by Petitioner's wife made her a *bona fide* partner, but then proceeded to test the validity

of the contribution by determining whether the transfer of corporate stock to her had also conveyed corporate assets. Except on this wholly untenable legal theory, the Tax Court made no finding that the transfer of corporate stock was ineffective or conditional. If the misapplication of legal theory is beyond redress, then the decisions of the Tax Court are beyond judicial review contrary to the review provisions of the Internal Revenue Code.

The Circuit Court of Appeals applied the *Tower* case here in such a way as to highlight the discrimination which that case imposes upon two persons identically situated, based upon the *history* of the partnership property out of which income has come. Such a result from the *Tower* case is inevitable unless the words "originating with the wife" be modified. Thus, in *S. Kenneth Alexander*, 6 T.C. 804, April 26, 1946, CCH Decision 15,102, acquiesced in by the Commissioner, the Tax Court held that partnership income was taxable to the wife where she *bought* a one-fourth interest in the partnership from her husband's uncle, even though she contributed no services to the partnership.

In *Harry Shulak*, CCH Decision 15,151 (M), already mentioned, the Tax Court similarly held that the purchase of an outstanding partnership interest by a wife made her a true partner of her husband. This means that taxability of partnership income in a particular year depends not upon services rendered in that year, nor upon a partnership share owned in that year, but upon the *history of how the partnership interest was acquired.* This means that identical interests will be taxed to the wife in one case and to the husband in the other, not because of anything occurring in the taxable year, not because of any distinction under state law of the right to receive income, not because of anything then inherent

in the partnership situation, but solely because, historically, one partnership interest was acquired by gift and the other was acquired by purchase. This is an earmarking of property on a purely artificial basis. It belies the protest of this Court in the *Tower* case that "command" and "control" over income is the true tax test. It bases taxation on history and not on then existing facts.

Furthermore, the *Tower* decision has been used by the Tax Court as warrant for ignoring not only state law but also the agreement between the partners. Thus in *Claire L. Canfield,* 7 T.C. No. 18, CCH Decision 15,225, decided June 13, 1946, where the wife contributed \$4,900 of necessary capital to the \$17,443.49 capital of an automobile sales agency the Tax Court held, in complete disregard of the partnership agreement providing for an equal distribution of profits, that the wife was to be taxed on 20% of the income and the husband on 80%.

Once the actualities of the state laws governing partnerships are disregarded, there is no stopping point. Either the Court should declare that husband and wife cannot be partners in any venture in which capital is important, and thus frankly legislate on the subject, or it should modify the *Tower* decision so that the question of what is a contribution to capital and what is control over income is remitted to state law for determination.

A refusal to do this leads not only to a continuation of the anomalous results already appearing in the Tax Court decisions, but will lead to serious injustices. The rights of the Petitioner's wife are governed by Michigan law. If income actually payable to her by a *bona fide* contract based upon a valuable consideration is taxed to the petitioner, he will not have funds to pay such taxes without invading his own income and eventually

his own capital. Petitioner's wife is not a party to this proceeding and is not bound by this Court's determination. Under Michigan law, there can be no doubt that Petitioner's wife may force payment to herself of 25% of any partnership distribution. Since Respondent contends these distributions to Petitioner's wife are Petitioner's income, he will, of necessity, further contend that amounts distributed by the partnership to Petitioner's wife are gifts by Petitioner. Thus Petitioner, if Respondent's contentions be sustained, would be in the unhappy predicament of being assessed income taxes and gift taxes without ever having in his possession or being able to retain even a sufficient amount of the subject matter to defray the tax. And because of cumulative tax rates, the more successful the partnership business, the worse Petitioner's predicament becomes.

The Respondent has not suggested how Petitioner can ever recover from his wife tax paid by Petitioner on partnership profits belonging to her, and the Revenue Act contains no method of Petitioner's obtaining relief. If this Court refuses to recognize the actualities of state law, this Court will place burdens on those situated as the Petitioner is situated which they will not have the means to discharge. We submit that this calls for a reexamination of the *Tower* case upon which the Respondent now relies.

Respectfully submitted,

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September 3, 1946.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Argument	6
Conclusion	8

CITATIONS

Cases:

American Box Shook Export Association v. *Commissioner*, decided June 27, 1946	7
Commissioner v. *Crescent Leather Co.*, 40 F. 2d 833	7
Commissioner v. *Tower*, decided February 25, 1946	6
Emerald Oil Co. v. *Commissioner*, 72 F. 2d 681	7
Flynn v. *Commissioner*, 77 F. 2d 180	7
Insurance & Title Guarantee Co. v. *Commissioner*, 36 F. 2d 842, certiorari denied, 281 U. S. 748	7
Lusthaus v. *Commissioner*, decided February 25, 1946	6
Sheppard & Myers, Inc. v. *Commissioner*, 45 F. 2d 50, certiorari denied, 282 U. S. 902	7

Statute:

Internal Revenue Code, Sec. 22 (26 U. S. C. Sec. 22)	2

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In the Supreme Court of the United States

October Term, 1946

No. 268

O. William Lowry, petitioner

v.

Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The majority and dissenting opinions in the Tax Court (R. 191–201) are reported at 3 T. C. 730. The opinion of the Circuit Court of Appeals (R. 222–225) is reported at 154 F. 2d 448.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 3, 1946. (R. 221.) The petition for a writ of certiorari was filed on July 3, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether family-partnership income credited on the books to petitioner's wife was properly taxed to the petitioner, under Section 22 (a), Internal Revenue Code.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> (26 U. S. C., Sec. 22.)

STATEMENT

The Tax Court's findings of fact (R. 181–190) may be summarized as follows:

By January, 1937, O. William Lowry, the petitioner, and Charles R. Sligh, Jr., owned equally all of the capital stock of the Charles R. Sligh Company, which manufactured and sold furniture and allied products. (R. 181.) In the spring of 1937 they felt that corporate taxes were "a drain

on the business and prevented its growth" and they discussed with their tax consultant and their attorney the advisability of forming a partnership with their wives. On May 24, 1937, Lowry transferred one-half of his shares to his wife. (R. 182.) In the spring of 1938 Lowry and Sligh again considered liquidating the corporation and forming a partnership to carry on the business. They discussed the matter on numerous occasions with their banker, tax consultant, insurance agent and attorney. They were advised by their tax consultant to wait until December, 1938, before making the move. On December 1, 1938, Sligh transferred one-half of his shares of stock to his wife. (R. 183.) On December 10, 1938, a plan for the complete liquidation of the corporation was adopted by the stockholders. (R. 183.) On December 15, 1938, all of the corporation's assets were distributed, subject to all liabilities, in redemption of all of the outstanding stock and in complete liquidation of the corporation. A limited partnership agreement was executed on December 16, 1938, designating Lowry and Sligh as general partners and their wives as limited partners. On the same day the four individuals executed a bill of sale conveying the machinery, furniture, inventories, and all tangible property, and interests in all intangible property to the general partners. On the previous day the land upon which the plant was

situated and two leases had been conveyed by the corporation directly to the general partners pursuant to directions of its stockholders. (R. 184.)

The limited partnership agreement provided, in part, that the limited partnership should exist for a term of five years, subject to extension at the option of the general partners; that the business shall be of the same nature as before, but that the general partners may engage in any other business without the consent of the limited partners; that the profits, after allowing for salaries to the general partners and others items, are to be divided into four parts but that no profits shall be distributed until the general partners so decide; that the limited partners are not personally liable for any losses of the firm and they are to be held harmless from liability for any of the liabilities of the corporation assumed by the partnership; that the value of the corporate assets transferred to the partnership shall be fixed by the general partners but these values are not conclusive as to the value of the interest of any partners upon the dissolution of the firm for any cause; and that neither the general nor the limited partners shall have the right to withdraw capital contributions. Upon dissolution, the limited partners had no right to demand property other than cash. Management and control of the business was solely in the hands of the general

partners. (R. 185–188.) The wives performed no services. (R. 190.)

For the partnership's first fiscal period, December 16, 1938, to May 31, 1939, its income tax return allocated $2,226.08 of net income to Mrs. Sligh and $2,226.07 to Mrs. Lowry. The partnership return for the fiscal year ending May 31, 1940, allocated $11,095.29 each to Mrs. Lowry and Mrs. Sligh. (R. 189.) Neither of the wives withdrew any money during the period ending May 31, 1939. During the period ending May 31, 1940, Mrs. Sligh's withdrawal account was charged $718.37 to pay her income tax. During the same period Mrs. Lowry's account was charged $1,309.56, of which about $500 was for the purchase of an automobile and the balance was for the payment of income tax. (R. 190.)

The Commissioner included in the incomes of Messrs. Lowry and Sligh for 1939 and 1940 the amounts reported by their respective wives as their shares of partnership income. The deficiency notice stated that this action was taken because the wives rendered no services and contributed no capital, as such, to the business and because each husband, in the close family group, retained dominion, control, and administration of the business. (R. 190.)

The Tax Court found that Messrs. Lowry and Sligh did not relinquish dominion and control over any part of the assets in the corporation by

reason of the gifts of stock in the corporation to their wives and consequently that the wives did not contribute any property to the capital of the partnership. (R. 190.) It held that Messrs. Lowry and Sligh were each to be taxed, under Section 22 (a) of the Internal Revenue Code, upon one-half of the partnership income for each of the taxable years. This conclusion was affirmed by the Circuit Court of Appeals.

ARGUMENT

The income tax treatment of family partnerships was recently before this Court in *Commissioner* v. *Tower,* No. 317, last Term, and *Lusthaus* v. *Commissioner,* No. 263, last Term, both decided February 25, 1946. In factual detail this case is almost identical with the *Tower* case and the court below adhered to the principles that properly govern the decision under this Court's opinions in these two cases.

The Tax Court's opinion carefully analyzes the facts and demonstrates the unreality of the purported transfers by the husbands to their wives, as well as the unreality of the wives' paper interests in the partnership which ensued. Its conclusions are amply supported by the evidence.

The court below did not, as petitioner suggests, fail to consider the question of the wife's contribution to the capital of the partnership but it accepted the Tax Court's finding, which was sup-

ported by evidence, that the petitioner and Sligh did not relinquish control over the assets of the corporation by their gifts of stock to the wives and the wives did not contribute any property to the partnership. This finding was of itself sufficient to support the conclusion of the Tax Court that the wives were not conducting a business with their husbands as a partnership within the meaning of the federal income tax statutes. In addition, the court below properly accepted as a finding of fact the statement in the Tax Court's opinion (R. 192, 195) to the effect that the gifts were made pursuant to a plan to dissolve the corporation and create a partnership with the wives as partners. *Commissioner* v. *Crescent Leather Co.*, 40 F. 2d 833 (C. C. A. 1st); *Insurance & Title Guarantee Co.* v. *Commissioner*, 36 F. 2d 842 (C. C. A. 2d), certiorari denied, 281 U. S. 748; *Sheppard & Myers, Inc.* v. *Commissioner*, 45 F. 2d 50 (C. C. A. 3d), certiorari denied, 282 U. S. 902; *Flynn* v. *Commissioner*, 77 F. 2d 180 (C. C. A. 5th); *American Box Shook Export Association* v. *Commissioner*, decided by the Ninth Circuit June 27, 1946 (1946 C. C. H., par. 9314); *Emerald Oil Co.* v. *Commissioner*, 72 F. 2d 681 (C. C. A. 10th).

The decision of the lower court is correct. The petitioner urges no reasons for granting the writ that would justify a review by this Court under its rules.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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AUGUST, 1946.

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